



## FAIR POLITICAL PRACTICES COMMISSION

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March 30, 2006

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**RE: Your Request for Advice**  
**Our File No. A-06-034**

This letter is in response to your request on behalf of the City of Benicia Councilmember Alan Schwartzman, for advice regarding the conflict-of-interest provisions of the Political Reform Act (the "Act").<sup>1</sup>

### QUESTION

Do the Act's conflict-of-interest provisions bar Mr. Schwartzman from participating in a building permit decision involving a client of Advance Mortgage, a business entity owned by Mr. Schwartzman and his wife?

### CONCLUSION

Mr. Schwartzman may participate in the building permit decision if no additional facts establish a reasonably foreseeable material financial effect on his economic interest(s).

### FACTS

Mr. Schwartzman, along with his wife owns Advanced Mortgage Services ("Advance Mortgage"). Advance Mortgage is a closely held corporation and Mr. Schwartzman and his wife each own a 50-percent interest. Mr. Schwartzman is a mortgage broker for Advance Mortgage and receives a salary and bonuses for his work.

Advance Mortgage is compensated for its services by charging the borrowers a fee at the closing of their loans. However, some loans are structured as "no fee" loans. If a loan is a "no fee" loan, Advance Mortgage will not receive a fee from the borrower at

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<sup>1</sup> Government Code sections 81000 – 91014. Commission regulations appear at Title 2, sections 18109-18997, of the California Code of Regulations.

closing. However, Advance Mortgage will recoup its fee from the investor/underwriter, who will provide Advance Mortgage with either a rebate or premium pricing on the higher interest rates.

On February 7, 2006, the city issued a building permit to Mr. William Royal. In a telephone conversation on March 20, 2006, you confirmed that Mr. Royal has appealed the building permit issued and that the city council will be deciding Mr. Royal's appeal. Mr. Schwartzman asks whether he may participate in the building permit decision considering Advance Mortgage received \$1,500 on January 15, 2005, from Mr. Royal.

### ANALYSIS

Section 87100 prohibits any public official from making, participating in making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. A public official has a "financial interest" in a governmental decision, within the meaning of the Act, if it is reasonably foreseeable that the governmental decision will have a material financial effect on one or more of the public official's economic interests. (Section 87103; regulation 18700(a).) The Commission has adopted an eight-step standard analysis for deciding whether an individual has a disqualifying conflict of interest in a given governmental decision, which we apply to your question. (Regulation 18700(b)(1)-(8).)

#### **Step One: Is Mr. Schwartzman a "public official?"**

The Act's conflict-of-interest provisions apply only to "public officials." (Sections 87100, 87103; regulation 18700(b)(1).) A "public official" is "every member, officer, employee or consultant of a state or local government agency...." (Section 82048.) As a councilmember for the City of Benicia, Mr. Schwartzman is a public official within the meaning of the Act.<sup>2</sup>

#### **Step Two: Is Mr. Schwartzman making, participating in making, or influencing a governmental decision?**

A public official "makes a governmental decision" when the official, acting within the authority of his or her office or position, votes on a matter, obligates or commits his or her agency to any course of action, or enters into any contractual agreement on behalf of his or her agency. (Regulation 18702.1.) A public official

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<sup>2</sup> If a public official's office is listed in section 87200 ("87200 filers" include members of city councils) and he or she has a conflict of interest in a decision noticed at a public meeting, then he or she must: (1) immediately prior to the discussion of the item, verbally identify each type of economic interest involved in the decision as well as details of the economic interest, as discussed in regulation 18702.5(b)(1)(B), on the record of the meeting; (2) recuse himself or herself; and (3) leave the room for the duration of the discussion and/or vote on the item. For closed sessions, consent calendars, absences and speaking as a member of the public regarding personal interests, special rules found in regulation 18702.5, subdivisions (c) and (d) apply. (Section 87105.)

“participates in a governmental decision” when, acting within the authority of his or her position and without significant intervening substantive review, the official negotiates, advises or makes recommendations to the decisionmaker regarding the governmental decision. (Regulation 18702.2.) A public official is attempting to use his or her official position to influence a decision if, for the purpose of influencing, the official contacts or appears before any member, officer, employee, or consultant of his or her agency. (Regulation 18702.3.)

As a councilmember, Mr. Schwartzman is making, participating in making, and/or influencing a government decision when participating in a decision to issue a building permit.

### **Step Three: What are the “economic interests” of Mr. Schwartzman?**

There are six kinds of economic interests recognized under the Act. Those pertinent to your account of the facts are the following:

*Business Entity* -- A public official has an economic interest in a business entity in which he or she has a direct or indirect investment of \$2,000 or more, or in which he or she is a director, officer, partner, trustee, employee, or holds any position of management. (Section 87103(a) and (d); regulations 18703.1(a) and (b).) “Indirect investment” is defined to include any investment or interest owned by the official’s spouse. (Section 87103.)

*Sources of Income* -- A public official has an economic interest in any source of income, including commission income, which aggregates to \$500 or more within 12 months prior to the decision. (Section 87103(c); regulation 18703.3.) “Income” is defined to include any community property interest in the income of a spouse and a pro rata share of the income of any business entity or trust in which the official (or his or her spouse) owns directly, indirectly, or beneficially, a 10-percent or greater interest. (Section 82030(a).) “Commission income” is defined as the “gross payments received by a public official as a result of services rendered as a broker, agent, or other salesperson for a specific sale or similar transaction.” (Regulation 18703.3(c)(1).)

*Personal Financial Effects* -- A public official has an economic interest in his or her personal finances. In particular, a government decision has a personal financial effect on a public official if the decision will result in the personal expenses, income, assets, or liabilities of the official increasing or decreasing. (Section 87103; regulation 18703.5.)

#### Advance Mortgage:

Mr. Schwartzman and his wife own Advance Mortgage. Each owns a 50-percent interest in the closely held corporation. Under the Act, Mr. Schwartzman has both a direct and an indirect investment in Advance Mortgage. From the facts submitted, we

will assume that Mr. Schwartzman's direct and indirect investments in Advance Mortgage total \$2,000 or more and that Mr. Schwartzman is a director, officer, employee, and/or manager of Advance Mortgage. Accordingly, Mr. Schwartzman has an economic interest in Advance Mortgage as a business entity pursuant to sections 87103(a) and (d). Additionally, we will assume that Mr. Schwartzman has received \$500 or more in income from Advance Mortgage in the 12 months prior to the decision. Accordingly, Mr. Schwartzman also has an economic interest in Advance Mortgage as a source of income pursuant to section 87103(c).

Client of Advance Mortgage:

Mr. Schwartzman owns a 10-percent or greater interest in Advance Mortgage. Consequently, sources of income to Advance Mortgage are considered sources of income to Mr. Schwartzman if Advance Mortgage receives income aggregating to \$667 within the 12 months prior to the decision.<sup>3</sup> From the facts provided, Mr. Royal paid Advance Mortgage \$1,500 on January 15, 2005. If the \$1,500 payment represents all gross payments owed to Advance Mortgage for the transaction with Mr. Royal, Mr. Schwartzman would not have an economic interest in Mr. Royal as a source of income since the payment was more than 12 months prior to the decision.

While the facts provided do not indicate any income for Advance Mortgage other than the \$1,500 provided by Mr. Royal, we point out that if Advance Mortgage has received or has been promised income in the form of a rebate or premium pricing on the higher interest rate, as a result of the transaction with Mr. Royal, such income would be considered "commission income" under regulation 18703.3(c)(1). If Advance Mortgage has received or been promised such "commission income" within the 12 months prior to the decision, Mr. Royal and the investor/underwriter may be considered sources of income to Mr. Schwartzman. (See regulation 18703.3.(c)(2)(B).)<sup>4</sup>

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<sup>3</sup> Mr. Schwartzman and his wife each own a 50-percent interest in Advance Mortgage. Mr. Schwartzman's pro rata share of the income is 50-percent. Mr. Schwartzman also has a community property interest in his wife's pro rata share of the income (also 50-percent) of Advance Mortgage. Consequently, Mr. Schwartzman has an interest in 75-percent of the income of Advance Mortgage. Should Advance Mortgage receive \$667 or more from a client in the 12 months prior to a decision, Mr. Schwartzman would have an economic interest in the client as a source of income since Mr. Schwartzman would have an interest in the income of \$500 or more. (See *Sato* Advice Letter, No. A-01-217.)

<sup>4</sup> If additional facts indicate that Advance Mortgage has received or has been promised additional income, as either a rebate or premium pricing on the higher interest rate from the investor/underwriter, as a result of the transaction with Mr. Royal, we would encourage you to seek further advice providing all relevant facts. If Mr. Royal qualifies as a source of income, there would be a high probability that Mr. Schwartzman would be prohibited by the Act from participating in the decision as Mr. Royal would be directly involved in the decision and the financial effect will be presumed material.

**Step Four: Are Mr. Schwartzman's economic interests directly or indirectly involved in the decision?**

After determining Mr. Schwartzman's economic interests it will be necessary to determine whether each interest is directly or indirectly involved in the decision. Regulation 18704.1(a) states that a business entity or source of income is directly involved in a decision before the official's agency when that business entity or source of income, either directly or by an agent:

“(1) Initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request or;

(2) Is a named party in, or is the subject of, the proceeding concerning the decision before the official or the official's agency. A person is the subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person.”

Business entities and sources of income which are *not* directly involved in governmental decisions under the rules quoted above are regarded as *indirectly* involved. (Regulation 18704.1(b).)

Advance Mortgage:

Advance Mortgage has not initiated the proceeding and is not a named party in, or subject of, the proceeding. Mr. Schwartzman's economic interest in Advance Mortgage as a business entity or source of income is only indirectly involved in the decision to issue a building permit to Mr. Royal.

Personal Finances:

As for Mr. Schwartzman's economic interest in his personal finances, if facts suggest any financial effect on Mr. Schwartzman's personal finances, Mr. Schwartzman's economic interest in his personal finances is deemed to be directly involved in the governmental decision.

**Steps Five and Six: Will there be a reasonably foreseeable material financial effect on Mr. Schwartzman's economic interest(s)?**

**Materiality**

Having identified the economic interests involved, and determined whether each interest is directly or indirectly involved in the decision at issue, it is necessary to identify the materiality standard appropriate to each economic interest.

Advance Mortgage:

For economic interests in business entities *indirectly* involved in a decision, including business entities which are a source of income to an official, the materiality standard is given at regulation 18705.1(c).

The thresholds for materiality under this regulation vary with the size of the business. While we do not know the size of Advance Mortgage, assuming the business is not publicly traded and it is of a relatively modest economic size, regulation 18705.1(c)(4) provides that “the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

“(A) The governmental decision will result in an increase or decrease in the business entity’s gross revenues for a fiscal year in the amount of \$20,000 or more; or,

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$5,000 or more; or,

(C) The governmental decision will result in an increase or decrease in the value of the business entity’s assets or liabilities of \$20,000 or more.”

Mr. Schwartzman should consult regulation 18705.1(c) to ensure that he identifies the materiality threshold actually appropriate to Advance Mortgage.

Personal Finances:

Effects on an official’s personal finances are material as stated in regulation 18705.5, which provides in pertinent part:

“(a) A reasonably foreseeable financial effect on a public official’s personal finances is material if it is at least \$250 in any 12-month period. When determining whether a governmental decision has a material financial effect on a public official’s economic interest in his or her personal finances, neither a financial effect on the value of real property owned directly or indirectly by the official, nor a financial effect on the gross revenues, expenses, or value of assets and liabilities of a business entity in which the official has a direct or indirect investment interest shall be considered.”

Under regulation 18705.5, a financial effect on the gross revenues, expenses, or value of assets and liabilities of Advance Mortgage would not be considered a material financial effect on Mr. Schwartzman's economic interest in his personal finances.

### **Foreseeability**

Once a public official has determined the materiality standards applicable to each of his or her economic interests, the next step is determining whether it is "reasonably foreseeable" that the standard will be met. A material financial effect on an economic interest is "reasonably foreseeable" if it is substantially likely that one or more of the materiality standards will be met as a result of the governmental decision. (Regulation 18706(a).) An effect need not be certain to be considered "reasonably foreseeable," but it must be more than a mere possibility. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

Ultimately, whether a material financial effect is foreseeable at the time a decision is made depends on facts and circumstances peculiar to each case. (*In re Thorner, supra.*) Because the Commission does not act as a finder of fact in providing advice (*In re Oglesby* (1975) 1 FPPC Ops. 71), the foreseeability of a particular financial effect is a determination that must be left, in most instances, to the informed judgment of the public official.

The facts provided indicate only that Mr. Royal used Mr. Schwartzman's company Advance Mortgage to obtain a loan. It appears that Advance Mortgage was paid \$1,500 by Mr. Royal for the services and that the fee was received approximately 14 months prior to the building permit decision the city council will soon face. Barring additional facts indicating a connection between the building permit issued to Mr. Royal and Mr. Schwartzman's business, Advance Mortgage, a material financial effect on Mr. Schwartzman's economic interest in Advance Mortgage is not foreseeable.

### **Steps Seven and Eight: Does this governmental decision come within any exception to the conflict-of-interest rules?**

Even if an official has a conflict of interest, disqualification is not required if the governmental decision affects the public official's economic interests in a manner that is indistinguishable from the manner in which the decision will affect the public generally. (Section 87103; regulation 18707(a).)

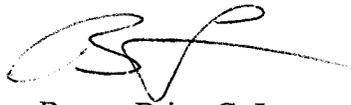
Additionally, in certain rare circumstances, a public official may be called upon to take part in a decision despite the fact that the official may have a disqualifying conflict of interest under the "legally required participation" exception. This exception applies only in certain very specific circumstances where the government agency would be paralyzed from acting. (Section 87101; regulation 18708.)

You have not presented any facts indicating that these exceptions are applicable to your situation, so we will not address them further.

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

Luisa Menchaca  
General Counsel

A handwritten signature in black ink, appearing to read "B. Lau", with a long horizontal flourish extending to the right.

By: Brian G. Lau  
Counsel, Legal Division

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